



September 5, 2007

Mr. Mark Leary, Executive Director
California Integrated Waste Management Board
1001 I Street, MS-1
P.O. Box 4025
Sacramento, CA 95812-4025

Dear Mr. Leary:

Final Audit Report: California Used Oil Recycling Fees—BP Lubricants USA, Inc.

Enclosed is our audit report on the Used Oil Recycling Fee Returns submitted by BP Lubricants USA, Inc. (BP Lubes) for the period January 1, 2005 through June 30, 2006. The Department of Finance, Office of State Audits and Evaluations (Finance), performed this audit under an interagency agreement with the California Integrated Waste Management Board. The scope of work included a review of reported fees and oil sales, internal control, and compliance with state law.

BP Lubes chose not to submit a written response; therefore, we are issuing the report as final. The enclosed report is for your information and use. We have also sent a copy to BP Lubes. In accordance with Finance's policy of increased transparency, the final report will be placed on the Finance website.

We appreciate the assistance and cooperation of BP Lubes staff during our audit. If you have any questions regarding this report, please contact Frances Parmelee, Manager, or Rick Cervantes, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Diana L. Ducay, Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Tom Estes, Deputy Director, Administration and Finance, California Integrated Waste Management Board
Ms. Susan Villa, Acting Branch Manager, Administration and Finance Division, California Integrated Waste Management Board
Mr. Roger Ikemoto, Grants and Audits Manager, Administration and Finance Division, California Integrated Waste Management Board
Ms. Julie Arico, Accounting Administrator, Administration and Finance Division, California Integrated Waste Management Board
Ms. Rubia Packard, Assistant Director, Executive Office, California Integrated Waste Management Board
Mr. W. Tom Baker, Excise Tax Audit Manager, BP America, Inc.
Mr. James C. Sacco, Audit Coordinator, BP America Inc.

AN OIL RECYCLING FEE AUDIT

BP Lubricants USA, Inc. Used Oil Recycling Fee Returns For the Period January 1, 2005 through June 30, 2006

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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The Department of Finance, Office of State Audits and Evaluations, performed this audit under an interagency agreement with the California Integrated Waste Management Board (Board).

BP Lubricants USA, Inc. (BP Lubes) reported \$3,085,305 in oil recycling fees to the Board for the period January 1, 2005 through June 30, 2006. The objectives of this audit were:

- To determine whether BP Lubes accurately reported oil sales and computed fees.
- To assess whether BP Lubes' internal control system allows for the accurate accounting of oil sales subject to the California Oil Recycling Enhancement Act.
- To verify BP Lubes' compliance with laws and regulations applicable to the California Oil Recycling Enhancement Act.

We did not assess the efficiency or effectiveness of program operations; this responsibility lies with the Board. The responsibility for financial reporting and compliance rests with BP Lubes.

This report is intended for the information and use of Board and BP Lubes management. However, the report is a matter of public record and its distribution is not limited.

STAFF:

Frances Parmelee, CPA
Manager

Rick Cervantes, CPA
Supervisor

Robert Castillo



INDEPENDENT AUDITOR'S REPORT

Mr. Mark Leary, Executive Director
California Integrated Waste Management Board
1001 I Street, MS-1
P.O. Box 4025
Sacramento, CA 95812-4025

We have audited the accompanying *Schedule of Lubrication Oil Sales, Exempt Transactions, and Fees Owed* and *Schedule of Industrial Oil Sales* (Schedules) with respect to the California Used Oil Recycling Fee Returns submitted by BP Lubricants USA, Inc. (BP Lubes) to the California Integrated Waste Management Board (Board) for the period January 1, 2005 through June 30, 2006. The Schedules were prepared from BP Lubes' records and are the responsibility of BP Lubes' management. Our responsibility is to express an opinion on the Schedules based on our audit.

We conducted our audit in accordance with *Generally Accepted Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to provide reasonable assurance as to whether the Schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Schedules. An audit also includes assessing the accounting principles used by management. The accompanying Schedules were prepared as described in Note 3. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the Statements referred to above present fairly, in all material respects, BP Lubes' lubrication oil sales, exempt transactions, and fees owed for the period January 1, 2005 through June 30, 2006.

Compliance

As part of obtaining reasonable assurance about whether the Schedules are free of material misstatement, we performed tests of BP Lubes' compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of Schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Generally Accepted Government Auditing Standards* and are described in the *Finding and Recommendations* section of the report.

Internal Control over Financial Reporting

In planning and performing our audit, we considered BP Lubes' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Schedules and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect BP Lubes' ability to record, process, summarize, and report financial data consistent with the assertions of management in the Schedules. The reportable condition is described in the *Finding and Recommendations* section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the Schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition to be a material weakness.

This report is intended solely for the information and use of Board and BP Lubes management, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record, and its distribution is not limited.

Original signed by Richard R. Sierra for:

Janet I. Rosman, CPA
Assistant Chief, Office of State Audits and Evaluations
(916) 322-2985

November 8, 2006

SCHEDULE OF LUBRICATION OIL SALES, EXEMPT TRANSACTIONS, AND FEES OWED

BP Lubricants USA, Inc.
For the Period January 1, 2005 through June 30, 2006

	<u>Per Fee Payer Returns</u>	<u>Per BP Lubes' Records</u>	<u>Differences*</u>
Sales			
Gross Lubrication Oil Sold (Gallons)	20,037,788	20,078,465	40,677
Less: Exempt Transactions (Gallons)	<u>(754,632)</u>	<u>(759,600)</u>	<u>(4,968)</u>
Total Lubrication Oil Sold (Gallons Subject to Fee)	<u>19,283,156</u>	<u>19,318,865</u>	<u>35,709</u>
Sales @ \$0.16/gallon	<u>\$ 3,085,305</u>	<u>\$ 3,091,018</u>	<u>\$ 5,713</u>

* Differences are based on results of the audit tests.

The accompanying notes are an integral part of this schedule.

SCHEDULE OF INDUSTRIAL OIL SALES

BP Lubricants USA, Inc.
For the Period January 1, 2005 through June 30, 2006

	<u>Per Fee Payer Returns</u>	<u>Per BP Lubes' Records</u>	<u>Difference in Gallons*</u>
Industrial Oil Sold (Gallons)	0	60,480	60,480

* Differences are based on results of the audit tests.

The accompanying notes are an integral part of this schedule.

NOTES TO THE SCHEDULES

BP Lubricants USA, Inc. For the Period January 1, 2005 through June 30, 2006

NOTE 1 Description of the Reporting Entity

BP Lubricants USA, Inc. (BP Lubes) is a wholly owned subsidiary of BP p.l.c. which manufactures and markets petroleum products. BP Lubes' corporate offices are located in Houston, Texas. The principle activities of BP p.l.c are exploration and production, gas power and renewables, refining and marketing, pipelines, and the sale of its petrochemical products worldwide.

NOTE 2 General Program Information

The Legislature enacted the California Oil Recycling Enhancement Act (Act) (Public Resources Code Sections 48600 through 48691) to reduce the illegal disposal of used oil, and to recycle and reclaim used oil in order to recover valuable natural resources and to avoid damage to the environment and threats to public health.

This Act provides the Board authority to adopt a used oil-recycling program. The Act also gives the Board responsibility and authority to receive quarterly reports from companies selling oil in California. Based on the level of reported oil sales, the companies are required to pay fees to the Board.

The Act describes the Board's process for depositing the fees into the California Used Oil Recycling Fund. Recycling incentive payments are the primary allowable fund appropriations.

NOTE 3 Basis of Presentation

The *Schedule of Lubrication Oil Sales, Exempt Transactions, and Fees Owed* and the *Schedule of Industrial Oil Sales* (Schedules) were prepared from BP Lubes' accounting records. These schedules summarize the fees paid and the lubrication oil sold during the reporting period January 1, 2005 through June 30, 2006.

FINDING AND RECOMMENDATIONS

During our audit, we identified a material weakness requiring corrective action. The following recommendations, if implemented, will improve the BP Lubricants USA, Inc.'s (BP Lubes) fiscal controls.

FINDING

Fee Payer Return Procedures Need Improvement

Condition:

BP Lubes does not have adequate fee payer return procedures in place, and as a result, did not report accurate gross lubrication and industrial oil sales. In comparing the amounts reported on the Oil Recycling Fee Returns (Returns) with the BP Lubes sales reports and sales invoices, the following errors were identified during our audit:

- Gross lubrication and exempt oil sales were underreported by 40,677 and 4,968 gallons, respectively. As a result, fee assessable gallons were underreported by 35,709 gallons and \$5,713 in additional fees is owed to the Board.
- Exemption certificates were not provided for any claimed exempt sales. These claimed exempted sales are included in the 40,677 underreported gallons stated above.
- Industrial oil sales were underreported by 60,480 gallons.
- The information system used to prepare sales reports supporting the Returns incorrectly classified as fee or non-fee assessable 29 products.

Without an adequate system in place, reliability of the Returns is reduced, and the Returns are more susceptible to errors and misstatements.

Criteria:

California Public Resources Code (PRC) Section 48671 states that oil manufacturers who sell lubricating or industrial oil in the state shall report to the Board the amount of lubricating or industrial oil sold each month.

PRC Section 48650 states that all oil manufacturers shall pay to the Board 16 cents for every gallon of lubricating oil sold or transferred in the state.

PRC Section 48618 defines lubrication oil as any oil intended for use in an internal combustion engine crankcase, transmission, gearbox, or differential in an automobile, bus, truck, vessel, plane, train, heavy equipment, or other machinery powered by an internal combustion engine.

PRC Section 48616 defines industrial oil as any compressor, turbine or bearing oil, hydraulic oil, metal-working oil, or refrigeration oil.

California Code of Regulations (CCR) Title 14 Section 18622 states that oil manufacturers must report lubricating and industrial oil sold in California.

CCR, Title 14, Section 18626 states that a seller is exempt from responsibility for the oil recycling fee when the purchaser certifies in writing, in a timely manner, to the seller that the lubricating oil purchased will be used in an exempt manner as provided in PRC Section 48650.

Recommendations: Remit \$5,713 in additional fees to the Board. The Board will make the final determination and resolution of fees due.

Report accurate industrial oil sales, lubricating oil sales, and oil recycling fees on the submitted Returns.

Ensure that lubricating and industrial oil sales are properly classified in the information system used to prepare sales reports supporting the Returns.

Retain exemption certificates to support exempt sales.

Perform second level reviews to ensure the accuracy of system entries and preparation of the Returns.